

In addition, if the cost proxy model does not conform to these requirements, use of the model will raise a significant constitutional “taking” issue for ILECs who are compelled to provide universal service but who are unable to recover their costs because of the cost model adopted by the Commission.

These represent significant economic and constitutional concerns created by the Hatfield Model for all ILECs -- large ILECs as well as high-cost rural ILECs. The Wyoming Public Service Commission’s (“Wyoming PSC”) comments are representative of the concerns of rural ILECs about the Hatfield Model:

To a certain extent, the Joint Board seemed to acknowledge the faults and disadvantages which would be visited on rural, high cost LECs if they were forced to use a proxy model to determine their costs of providing service because it found none of the proxy models presented to it to be acceptable. Therefore, for at least three years, rural LECs are not required to use a proxy model and may use current levels of actual embedded costs. We are concerned that a later mandate to rural LECs that they must use a proxy model will rob them of any assurance that the modeling exercise will produce results that meet the ‘specific, predictable and sufficient’ principles necessary for a true universal service support program. There is sufficient reason for alarm. Independent analyses have already been performed comparing the costs results of the BCM2 and the Hatfield models with actual USF cost data reported to the National Exchange Carrier Association (NECA). Not surprisingly, the cost data results for rural high cost LECs produced by the proxy models have differed significantly from the actual costs of these LECs. The models, in short, have not produced a sufficient substitute for reality. Compounding the problem, even under comparable assumptions and even with *identical* data inputs, the Hatfield model and BCM2 model produce substantially different results.<sup>58</sup>

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<sup>58</sup> Wyoming PSC at 8.

The Wyoming PSC's observations confirm U S WEST's view of the Hatfield Model. The fundamental defect with the Hatfield Model is not merely the input, but the underlying design of the model itself. As the Wyoming PSC says, even when comparable inputs are employed with both the Hatfield Model and the BCM2, the cost outputs as between the two models vary wildly. The concerns of rural ILECs can be accommodated by the new BCPM which U S WEST supports. Their concerns cannot be addressed in a similar way with the Hatfield Model, because its design is fundamentally flawed.

For all of these reasons, U S WEST urges the Commission to reject the Hatfield Model and to bring closure to these concerns.

VI. YELLOW PAGES REVENUES SHOULD NOT BE INCLUDED IN CARRIERS' USF ASSESSMENTS

Some commenters argue that those carriers having yellow pages revenue should have such revenue included in their base revenue (that revenue base being dependent on Commission determination) for USF assessment purposes.<sup>59</sup> The Commission should reject these arguments for at least two reasons.

First, yellow pages revenues are not revenues generated by a telecommunications service. They are monies associated with the First Amendment-protected activity of editing and publishing directories. Indeed, in U S WEST's case, the activity of yellow pages publication is not even conducted in U S WEST's local exchange service corporation. Rather, the publishing is done

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<sup>59</sup> See, e.g., AT&T at 7 n.3; Ad Hoc Telecommunications Users Committee at 12-14; Time Warner at 21-23.

through an affiliate corporation with its own directors and Board. Furthermore, the stock associated with the yellow pages operation is traded through the deregulated Media Group offerings, not the regulated Communications Group. The directory publishing corporation is not a telecommunications carrier providing interstate service. Thus, by the specific language of the statute, its revenue stream is not available for universal service funding purposes.

Second, there is a serious constitutional problem associated with regulatory agencies imputing non-common carrier revenues into common carrier revenue bases for purposes of furthering common carrier regulatory purposes. U S WEST has, in fact, filed suit against certain state commissions for their continued activities associated with yellow pages revenues. A copy of U S WEST's brief in New Mexico (in support of a summary judgment motion) is attached hereto as Appendix A. As demonstrated by that brief, imputing yellow pages revenue to local telephone service (or, universal service funding as is involved here) violates the First and Fourteenth Amendments to the Constitution.

Imputation effectively removes (or adversely taxes, as would be the case with universal service funding) the profits earned through yellow pages publishing, imposing a financial disincentive on speech. Furthermore, use of U S WEST's non-regulated property to support and advance regulatory goals would violate the Takings and Due Process Clauses of the Constitution. The prohibitions in those clauses on confiscatory rates necessarily include a limitation on a regulator's ability to establish regulated funding mechanisms by reference to non-public utility

businesses, which involve property in which ratepayers have no interest, as well as other activities outside the regulator's jurisdiction.

For the above reasons, the claim that yellow pages revenues should be included in a carrier's base of revenue tapped for universal service funding should be rejected.

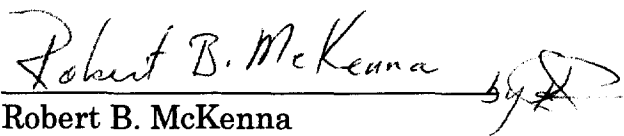
## VII. CONCLUSION

The Joint Board's Recommended Decision and the comments of many interested parties reflect analyses and recommendations supported by sound cost/benefit analyses and public interest considerations. In some cases, however, the Recommended Decision recommends positions, and some commenters advocate theories, that go beyond sound economic, regulatory, and constitutional analysis. These Reply Comments focus on those deviations from principle.

Respectfully submitted,

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January 10, 1997

**IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF NEW MEXICO**

U S WEST, INC., et al.,

Plaintiffs,

vs.

CIV No. 96-01366 MV/WWD

GLORIA TRISTANI, et al.,

Defendants.

**MEMORANDUM IN SUPPORT OF PLAINTIFFS' MOTION  
FOR SUMMARY JUDGMENT**

Plaintiffs U S WEST, Inc., U S WEST Communications, Inc. (USWC), and U S WEST Dex, Inc. (formerly U S WEST Marketing Resources Group, Inc.), respectfully move this Court for summary judgment in this case pursuant to Fed. R. Civ. P. 56.

**INTRODUCTION**

This case presents the purely legal question of the constitutionality of the defendants' policy, pursuant to Article XI, § 7 of the New Mexico Constitution,<sup>1</sup> of imputing to USWC revenues earned by U S WEST Dex from publishing Yellow Pages in USWC's service area. Defendants have treated those revenues as if they were earned by USWC — even though U S WEST Dex and USWC are entirely separate corporations, the publication of Yellow Pages is not a part of the telephone service provided in New Mexico by USWC, and New Mexico ratepayers bear none of the costs and risks associated with the publication of Yellow Pages by U S WEST Dex. Each year, defendants impute more than \$12.6 million of Yellow Pages

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<sup>1</sup> In the recent November elections, New Mexico voters repealed Art. XI, § 7, effective 1999. The defendants have not suggested that this action would alter their policy of imputation.

revenue to USWC, which has the effect of depressing by this amount the revenue that USWC is otherwise permitted to earn through telephone service. See Affidavit of Ann Koehler-Christensen ("Koehler-Christensen Aff.") ¶s 3 and 4.

Although historically many state public utility commissions have imputed Yellow Pages revenue to local telephone service, the practice has never been challenged under the constitutional principles that plaintiffs advance in this case. With the emergence of competition in local telephone markets and the increasing availability of Yellow Pages directories from competing publishers, it is now clear that Yellow Pages are not an element of the public utility business in which local telephone companies are engaged. It is therefore vital to re-examine the justifications for imputation, especially in light of the constitutional concerns that plaintiffs have now adduced.

Imputation violates plaintiffs' rights to speech and press under the First and Fourteenth Amendments, and deprives plaintiffs of their property in violation of the Fifth and Fourteenth Amendments. These legal conclusions do not depend on any disputed issues of material fact. No extensive discovery is necessary in this case. Accordingly, the matter is ripe for decision on motions for summary judgment by either side.

#### **I. IMPUTING YELLOW PAGES REVENUE TO LOCAL TELEPHONE SERVICE VIOLATES THE FIRST AND FOURTEENTH AMENDMENTS**

The First Amendment to the United States Constitution guarantees the freedoms of speech and press. It applies to the States through the Due Process Clause of the Fourteenth Amendment. E.g., Grosjean v. American Press Co., 297 U.S. 233, 245 (1936); Gitlow v. New York, 268 U.S. 652, 666 (1925). Imputing Yellow Pages revenue to local telephone service violates the First Amendment.

**A. YELLOW PAGES PUBLISHING IS FULLY PROTECTED BY THE  
SPEECH AND PRESS CLAUSES OF THE FIRST AMENDMENT**

Yellow Pages publishing involves the exercise of creativity and editorial discretion in creating subject-matter categories for different kinds of advertisements; developing formats and color options for advertisements; designing individual advertisements; deciding how to treat certain kinds of sensitive entries relating to unusual and distinct businesses and compiling and arranging individual advertisements into groups. See Affidavit of Ernest J. Sampias ("Sampias Aff.") ¶ 2. In short, Yellow Pages publishing involves the editorial tasks of selecting, combining, arranging, organizing, and presenting information to the public.

"[T]he editorial function itself is an aspect of 'speech' . . . ." Denver Area Educ. Telecom. Consortium v. FCC, 116 S. Ct. 2374, 2383 (1996) (plurality opinion). Yellow Pages publishing involves the same kind of editorial discretion as organizing a parade, choosing cable programming, and publishing a newspaper by selecting material from wire services. Hurley v. Irish-American Gay, Lesbian and Bisexual Group of Boston, 115 S. Ct. 2338, 2345 (1995); Turner Broadcasting Sys., Inc. v. FCC, 114 S. Ct. 2445, 2456 (1994).

As an expressive activity akin to newspaper publishing or parade organizing, Yellow Pages publishing is entitled to full and undiluted constitutional protection. Individual Yellow Pages advertisements propose commercial transactions, and thus fall within the definition of commercial speech. E.g., Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n, 447 U.S. 557, 566 (1980). The publication of an entire Yellow Pages directory, however, involves an exercise of editorial discretion different in kind, and not merely in degree, from that involved with the production of each individual advertisement. In addition, Yellow Pages include more than just advertisements. They often contain listings of emergency

numbers; maps; consumer pages with a variety of information; recycling information; and other materials as well. See Sampias Aff., ¶ 3. See also Riley v. National Fed'n of the Blind, 487 U.S. 781, 796 (1988) (applying full First Amendment scrutiny to requests for donations, which are purely commercial speech, when combined with non-commercial "informative and perhaps persuasive speech") (citation omitted).

Moreover, "[t]he mere fact that messages propose commercial transactions does not in and of itself dictate the constitutional analysis that should apply to decisions to suppress them." 44 Liquormart, Inc. v. Rhode Island, 116 S. Ct. 1495, 1507 (1996) (principal opinion). "When a State regulates commercial messages to protect consumers from misleading, deceptive, or aggressive sales practices, or requires the disclosure of beneficial consumer information, the purpose of its regulation is consistent with the reasons for according constitutional protection to commercial speech and therefore justifies less than strict review." Id. However, when a State imposes restrictions on commercial messages "for reasons unrelated to the preservation of a fair bargaining process, there is far less reason to depart from the rigorous review that the First Amendment generally demands." Id. The imputation of Yellow Pages revenue to local telephone service does not protect consumers from misleading or deceptive advertisements. Accordingly, there is no reason to subject imputation to anything less than full First Amendment scrutiny.

In any event, Yellow Pages publishing is entitled at minimum to intermediate First Amendment protection as a form of commercial speech. E.g., Rubin v. Coors Brewing Co., 115 S. Ct. 1585, 1592-93 (1995); Ibanez v. Florida Dept. of Business & Professional Reg.,

512 U.S. 136 (1994); City of Cincinnati v. Discovery Network, Inc., 507 U.S. 410, 416-17 (1993); Edenfield v. Fane, 507 U.S. 761, 767-68 (1993).

**B. IMPUTING YELLOW PAGES REVENUE TO LOCAL TELEPHONE SERVICE IS A DIRECT INFRINGEMENT OF THE RIGHTS TO FREE SPEECH AND PRESS**

Imputing Yellow Pages revenue to local telephone service directly infringes the rights to free speech and press, in two separate respects.

1. Imputation effectively removes the profits earned through Yellow Pages publishing, imposing a financial disincentive on speech. Every dollar that USWC is constructively deemed to have earned through Yellow Pages publishing is a dollar that it cannot recover through telephone service rates. Imputation thus operates as a direct financial disincentive on Yellow Pages publishing, akin to a special tax on income derived from book or magazine publishing.

Apposite here is NTEU v. United States, 115 S. Ct. 1003 (1995), where the Supreme Court invalidated a ban on the receipt of honoraria by government employees for making a speech or writing an article. The Court acknowledged that the law did not prohibit any speech outright but nonetheless held that the statute “unquestionably imposes a significant burden on expressive activity.” Id. at 1014. “Publishers compensate authors because compensation provides a significant incentive toward more expression. By denying [government employees] that incentive, the honoraria ban induces them to curtail their expression if they wish to continue working for the Government.” Id. Yellow Pages revenue imputation resembles an honoraria rule reducing a government employee’s salary

by any outside speaking income. That rule would be as invalid as the one actually invalidated by the Court in NTEU.

The First Amendment forbids financial disincentives on expression, just as it forbids straightforward prohibitions on speech. In Simon & Schuster, Inc. v. Members of New York State Crime Victims Bd., 502 U.S. 105 (1991), for example, the Supreme Court invalidated New York's "Son of Sam" law directing to a victims' compensation fund any revenues to be received by a person accused or convicted of a crime from the production of a book or other work describing the crime. Although the statute did not in any way prohibit speech — it merely deprived the speaker of the income from speech — the Court applied full First Amendment scrutiny because the law "establish[ed] a financial disincentive to create or publish" works regarding the crime. Id. at 118.

Indeed, the Supreme Court has recognized in a wide variety of contexts that regulating the financial aspects of speech in essence regulates speech itself. In Village of Schaumburg v. Citizens for a Better Environment, 444 U.S. 620, 636 (1980), for example, the Supreme Court held that a rule requiring at least 75% of the proceeds of charitable solicitations to be used directly for the charitable purpose of the organization was invalid as "a direct and substantial limitation on protected activity."<sup>2</sup> Similarly, the Court has also recognized that

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<sup>2</sup> See also Colorado Republican Campaign Comm. v. FEC, 116 S. Ct. 2309, 2315-16 (1996) (invalidating restrictions on political party expenditures); Riley v. National Fed'n of the Blind, 487 U.S. 781, 789 n.5 (1988) (striking down a charitable solicitation act regulating the "reasonable fee" that a professional fundraiser could charge, and rejecting the suggestion that such a regulation "is merely economic, having only an indirect effect on protected speech"); Meyer v. Grant, 486 U.S. 414, 422 (1988) ("The refusal to permit [groups] to pay petition circulators restricts political expression . . . ." and violates the First Amendment); Secretary of State v. Joseph H. Munson Co., 467 U.S. 947, 967 n.16 (1984) (state law prohibiting charity, in connection with fund-raising activity, from paying expenses of more than 25% of the amount raised, was invalid as "a direct restriction on the charities' First Amendment activity" and did not regulate "only the economic relationship between charities and

full First Amendment scrutiny applies to fees on expressive activities,<sup>3</sup> and taxes on various forms of speech.<sup>4</sup>

The financial penalty on expression caused by Yellow Pages revenue imputation is every bit as plain as a direct tax on speech. As with other laws imposing financial disincentives on speech and regulating the financial aspects of expression, it is subject to full First Amendment scrutiny.

2. Yellow Pages revenue imputation directly restricts speech for a related but distinct reason: it nullifies the right of a parent corporation like U S WEST, Inc. to create a separate affiliate, or to pursue other organizational options, free of the inhibition of regulation, while allowing government to achieve all of its aims without gratuitously restricting constitutionally protected activity.

U S WEST Dex, not USWC, incurs the expenses of White and Yellow Pages publishing. See Koehler-Christensen Aff., ¶s 6 and 7; Sampias Aff., ¶ 8. USWC does not charge those expenses to regulated telephone service. Koehler-Christensen Aff., ¶s 3 and 4. U S WEST Dex earns Yellow Pages revenue on individual contracts with advertisers, who may not even use USWC service. Sampias Aff., ¶s 4 and 9.

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professional fundraisers").

<sup>3</sup> See, e.g., Forsyth County v. Nationalist Movement, 505 U.S. 123, 136-37 (1992).

<sup>4</sup> See, e.g., Arkansas Writers' Project, Inc. v. Ragland, 481 U.S. 221, 227-31 (1987) (tax on magazines unconstitutional); Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue, 460 U.S. 575, 581, 591 (1983) (tax on paper and ink); Murdock v. Pennsylvania, 319 U.S. 105, 112 (1943) (tax on sales as applied to religious literature); Grosjean v. American Press Co., 297 U.S. 233, 250 (1936) (gross receipts tax on newspapers).

There are two classes of U S WEST common stock: U S WEST Communications Group Common Stock and U S WEST Media Group Common Stock. The Communications Stock and Media Stock provide shareholders with two distinct securities that reflect separately the communications and media businesses of U S WEST. See Sampias Aff., ¶ 1. Revenues from Yellow Pages publishing have been pledged to the shareholders of the Media Group stock, of which U S WEST Dex is a member. By contrast, USWC belongs to the U S WEST Communications Group. Id. In short, U S WEST Dex and USWC are legally distinct corporations with different businesses.

The defendants, however, have nullified the ability of U S WEST to set up separate entities in order to speak. As a matter of form, U S WEST may do so, but as a matter of substance, any profits that separate entities earn will be imputed back to USWC, as if there were no independent status at all. Yet the Supreme Court has frequently recognized the importance, in the First Amendment context, of permitting corporate speakers to choose a corporate form that would permit them to speak without the inhibition of the surrounding array of government regulations. For example, in FEC v. Massachusetts Citizens for Life, Inc., 479 U.S. 238 (1986) ("MCFL"), the Supreme Court invalidated a federal statute requiring corporations to make political expenditures only through special segregated funds, 2 U.S.C. § 441b, as applied to a nonprofit advocacy group. See 479 U.S. at 252-53 (plurality opinion); id. at 266 (O'Connor, J., concurring in part and concurring in the judgment).

In FCC v. League of Women Voters, 468 U.S. 364 (1984), the Court invalidated a ban on editorializing imposed by Congress on federally funded noncommercial television and

radio stations. The Court reasoned that, because Congress did not give the broadcasters the option of setting up separate non-subsidized entities through which to speak, the condition on federal funds acted as a penalty on editorializing: a noncommercial broadcast station "is not able to segregate its activities according to the source of its funding. The station has no way of limiting the use of its federal funds to all noneditorializing activities . . . ." *Id.* at 400. In order to engage in editorializing, the station would suffer the penalty of losing federal funds altogether.

In the same way, by imputing Yellow Pages revenue to USWC, the defendants have treated the two separate corporations as if they were one. And just as the broadcasters in League of Women Voters suffered a funding penalty, so too U S WEST suffers a ratemaking penalty: the revenue imputation arbitrarily lowers the telephone revenue requirement it would otherwise be permitted to earn. In short, USWC is penalized because the expressive activities of a separate entity are profitable.

**C. YELLOW PAGES REVENUE IMPUTATION IS SUBJECT TO STRICT SCRUTINY**

Yellow Pages revenue imputation is properly subject to strict scrutiny under the First Amendment as a direct infringement on speech as such. Intermediate First Amendment scrutiny is reserved exclusively for instances where a regulation does not target the message-generating dimensions of conduct — *i.e.*, where a "regulation is not related to expression." Texas v. Johnson, 491 U.S. 397, 403 (1989). *See, e.g., Cohen v. California*, 403 U.S. 15, 18 (1971) ("The only 'conduct' which the state sought to punish is the fact of communication. Thus, we deal here with a conviction resting solely upon 'speech,' . . . not upon any separately identifiable conduct.").

The Supreme Court has always applied strict scrutiny to laws having a direct effect on the financial aspects of speech, regardless of whether they discriminate on the basis of the content or viewpoint of expression. For example, in Buckley v. Valeo, 424 U.S. 1 (1976) (per curiam), the Supreme Court applied "exacting scrutiny" to expenditure limitations that were "direct and substantial restraints on the quantity" of speech itself, id. at 39, 44, even though they were "neutral as to the ideas expressed." Id. at 39.<sup>5</sup> In Village of Schaumburg v. Citizens for a Better Environment, 444 U.S. 620 (1980), the Court held that a restriction that solicitors must use at least 75 percent of their receipts for "charitable purposes" was "a direct and substantial limitation on protected activity," not a "narrowly drawn regulation" of solicitation. Id. at 636-37. The Court applied the strict scrutiny of cases like First National Bank v. Bellotti, 435 U.S. 765, 786 (1978) (cited in Schaumburg, 444 U.S. at 637) to invalidate the restriction on expression.<sup>6</sup> Similarly, the Supreme Court has applied strict scrutiny to taxes on expression.<sup>7</sup>

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<sup>5</sup> See also Simon & Schuster v. New York Crime Victims Bd., 502 U.S. 105, 126 (1991) (Kennedy, J., concurring in judgment) (noting the content-neutral character of the expenditure limitations invalidated in Buckley).

<sup>6</sup> See also Riley v. Nat'l Fed'n of Blind, 487 U.S. 781, 788-89 (1988) (explaining that "exacting First Amendment scrutiny" applies to "a direct restriction on the amount of money a charity can spend on fundraising activity" because such a law is "a direct restriction on protected First Amendment activity") (internal quotations omitted); Meyer v. Grant, 486 U.S. 414, 419-20 (1988) (applying "exacting scrutiny" to strike down a ban on the use of paid petition circulators which "impose[d] a direct restriction which 'necessarily reduces the quantity of expression'"); Secretary of State v. J.H. Munson Co., 467 U.S. 947, 965 n.13 (1984) (invalidating solicitation rule that "directly restricts protected First Amendment activity and does not employ means narrowly tailored to serve a compelling governmental interest").

<sup>7</sup> E.g., Minneapolis Star & Tribune Co., 460 U.S. 575, 585 (1983) (tax on press "presumptively unconstitutional," and State must assert "counterbalancing interest of compelling importance that it cannot achieve without differential taxation"); Murdock, 319 U.S. at 113, 117 (license tax is "as potent as the power of censorship which this Court has repeatedly struck down" unless "narrowly drawn to safeguard the people of the community").

Further, the Supreme Court has also applied strict scrutiny to laws that violate the rights of corporations to pursue organizational options that enable government to achieve all of its interests without unnecessarily restricting constitutionally protected expression. See, e.g., MCFL, 479 U.S. at 251 (plurality opinion) (applying strict scrutiny and demanding a “compelling” governmental interest).

For all these reasons, strict scrutiny is appropriate here.

**D. YELLOW PAGES REVENUE IMPUTATION COULD NOT SURVIVE ANY FORM OF FIRST AMENDMENT SCRUTINY**

Yellow Pages revenue imputation cannot survive either strict scrutiny or intermediate review under the First Amendment.

Under strict scrutiny, a restriction on speech is unconstitutional unless it is “a narrowly tailored means of serving a compelling state interest.” Pacific Gas & Elec. Co. v. Public Utilities Comm’n, 475 U.S. 1, 19 (1986) (plurality opinion). Even if the State’s interest here qualifies as “compelling” — which is open to doubt<sup>8</sup> — this test is not satisfied where “the State can serve that interest through means that would not violate [the plaintiff’s] First Amendment rights.” Id. “Only rarely are statutes sustained in the face of strict scrutiny. As one commentator observed, strict-scrutiny review is ‘strict’ in theory but usually ‘fatal’ in fact.” Bernal v. Fainter, 467 U.S. 216, 220 n.6 (1984); see also Villanueva v. Carere, 85 F.3d 481, 488 (10th Cir. 1996) (“strict scrutiny . . . is almost always fatal”).

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<sup>8</sup> See, e.g., Near v. Minnesota ex rel. Olson, 283 U.S. 697, 716 (1931) (“No one would question but that a government might prevent actual obstruction to its recruiting service or the publication of the sailing dates of transports or the number and location of troops.”).

Under First Amendment intermediate scrutiny, a restriction on speech is unconstitutional unless it is “narrowly tailored to serve a significant governmental interest.” Ward v. Rock Against Racism, Inc., 491 U.S. 781, 799 (1989). Under this requirement, the Government must demonstrate “that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way.” Turner Broadcasting Co. v. FCC, 114 S. Ct. 2445, 2470 (1994) (plurality opinion). The Government must show that “the means chosen do not ‘burden substantially more speech than is necessary to further the government’s legitimate interests.’” Id. at 2469 (quoting Ward, 491 U.S. at 799).

The defendants, who bear the burden of justifying the infringement on First Amendment rights, *e.g.*, 44 Liquormart, Inc. v. Rhode Island, 116 S. Ct. 1495, 1509 (1996), cannot show that Yellow Pages revenue imputation is narrowly tailored to any substantial or important governmental interest, much less a compelling one. A fortiori, Yellow Pages revenue imputation could not survive the more demanding requirements of strict scrutiny, to which the state law is properly subject as a gross and direct abridgment of speech.

1. The defendants attempt to justify Yellow Pages revenue imputation as a subsidy to local phone rates. See Br. in Support of Defs. Motion to Dismiss at 6. But there is no special link between Yellow Pages and universal access; Yellow Pages just happen to be a profitable publishing venture in which telephone company affiliates are engaged. Imputing directory revenues is like a rule that newspapers must use revenues from their classified ads to subsidize sales of newspapers to schools and low-income people. In NTEU v. United

States, 115 S. Ct. 1003 (1995), the Court held that an honoraria ban that singled out speech activities for special burdens was too “crudely crafted” to survive First Amendment scrutiny. Id. at 1018. In the same way, imposing a substantial disincentive on speech in order to subsidize telephone service cannot be narrowly tailored to the government’s interest.

Moreover, the manner in which Yellow Pages revenue imputation relates to universal service demonstrates that it is not narrowly tailored to that interest. The effect of imputation on telephone rates paid by consumers is only indirect. In the first instance, imputation simply lowers USWC’s revenue requirement. See Koehler-Christensen Aff., ¶ 4. There is no assurance that the rate structure ultimately adopted by the Commission will in fact provide lower rates for those telephone users who might need aid. Accordingly, Yellow Pages revenue imputation fails the requirement of narrow tailoring that a regulation “‘may not be sustained if it provides only ineffective or remote support for the government’s purpose.’” 44 Liquormart, 116 S. Ct. at 1509 (citation omitted); see also Rubin v. Coors Brewing Co., 115 S. Ct. 1585, 1591 (1995) (restriction must “directly advance the governmental interest and be no more extensive than necessary to serve that interest”); Edenfield v. Fane, 507 U.S. 761, 771 (1993) (regulation must advance government’s interest “to a material degree”).

Further, there are many other obvious, more targeted, and far less speech-intrusive ways to promote universal service. Thus, Yellow Pages revenue imputation is not “narrowly tailored” to the relevant government interest, as even intermediate First Amendment scrutiny

demands.<sup>9</sup> The federal Telecommunications Act of 1996 contains extensive provisions to subsidize universal service on an explicit, equitable, and nondiscriminatory basis, funded by all providers of intrastate service. 47 U.S.C. § 254(f). There is no need for Yellow Pages imputation.

In fact, imputation runs contrary to the universal service provisions of the federal Act. The many other alternative providers of telephone service in New Mexico that do not publish their own Yellow Pages directories are not subject to the burden of imputation. See Sampias Aff., ¶ 5. Imputation is also inconsistent with Congress' instruction that "any support mechanism continued or created under the new section 254 should be explicit, rather than implicit as many support mechanisms are today." Joint Explanatory Statement of the Committee of Conference, H.R. Rep. No. 458, S. Rep. No. 230, 104th Cong., 2d Sess. 131 (1996).

Imputation interferes with the 1996 Act for the additional reason that it has the effect of hindering new entry into local phone service markets. As one state commissioner has admitted, "[i]ncreasing the imputation would not seem likely to encourage competition. The Company can use many millions of dollars from the directory revenues to help pay for local service. Thus, users who incur costs may not be paying them." In re U S WEST Communications, Inc., 1995 General Rate Case, Docket No. 95-049-05, at 111 (Utah PSC Dec. 1, 1995) (Commissioner White, dissenting). The 1996 Act, by contrast, seeks to

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<sup>9</sup> See 44 Liquormart, 116 S. Ct. at 1510 ("It is perfectly obvious that alternative forms of regulation that would not involve any restriction on speech would be more likely to achieve the State's goal"); Rubin v. Coors Brewing Co., 115 S. Ct. at 1593-94 ("the availability of these options, all of which could advance the Government's asserted interest in a manner less intrusive to . . . First Amendment rights, indicates that [the law] is more extensive than necessary"); City of Cincinnati v. Discovery Network, Inc., 507 U.S. 410, 417 & n.13 (1993) (considering possible alternatives to restriction on speech).

deregulate local telephone markets and introduce competition into them. The Act provides that “[n]o State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.” 47 U.S.C. § 253(a).

In their motion to dismiss, the defendants observe that Judge Harold Greene, in implementing the AT&T consent decree, believed that Yellow Pages revenues would provide a cross-subsidy to local telephone rates. Brief in Support of Defs. Motion to Dismiss at 3 (citing United States v. AT&T, 552 F. Supp. 131 (D.D.C. 1982), aff’d mem., 460 U.S. 1001 (1983)).<sup>10</sup> Defendants fail to mention, however, that Judge Greene expressly recognized that Yellow Pages publishing was distinct from telephone service. He explained that “there is no possibility of improper discrimination by the [Bell] Operating Companies against competing directory manufacturers since access to the local exchange is not required for production of a printed directory.” United States v. AT&T, 552 F. Supp. at 193 (emphasis added). In any event, Judge Greene’s sole justification for assigning Yellow Pages publishing to the Bell Operating Companies — the subsidization of local telephone rates — has now been thoroughly undermined by the federal Telecommunications Act of 1996.

2. Nor can Yellow Pages revenue imputation be justified as an “accounting adjustment.” Br. in Support of Defs. Motion to Dismiss at 2. If U S WEST operated a

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<sup>10</sup> Notably, in other contexts Judge Greene condemned cross-subsidies between different services. See, e.g., United States v. AT&T, 552 F. Supp. at 172, 188, 192; United States v. Western Elec. Co., 592 F. Supp. 846, 853, 863 (D.D.C. 1984); United States v. Western Elec. Co., 673 F. Supp. 525, 581-83 (D.D.C. 1987).

newspaper or a book publishing house, defendants could not impute income derived therefrom to telephone service. The same principle applies here, for Yellow Pages publishing is a non-public-utility business and U S WEST Dex is in no sense a public utility.

Yellow Pages publishing is wholly separate from the provision of local telephone service. The New Mexico State Corporation Commission has not required a certificate of public convenience and necessity for the publication of Yellow Pages directories. Yellow Pages publishing is not protected by a telephone company's local franchise; it was always open to competition. New Mexico has twenty-six (26) Yellow Pages publishers besides U S WEST Dex. See Sampias Aff., ¶ 4. Many of these do not provide any telephone service in New Mexico. Id., ¶ 4. Conversely, New Mexico has thirteen (13) providers of telephone service other than USWC, and many of these do not publish their own Yellow Pages directories. Id., ¶ 5. At least eighteen (18) independent Yellow Pages directories compete directly against U S WEST Dex directories in the same geographic areas. See id., ¶ 6. U S WEST Dex's competitors include such well-financed alternative providers as Western States Publishers (\$2.5 million in revenues), Alltel (over \$100 million), and GTD (over \$100 million). See id., ¶ 6. In addition, U S WEST Dex faces competition from electronic Yellow Pages, such as the directories offered by NYNEX and GTD, which are accessible over the Internet. Id., ¶ 10.

USWC makes listings available to U S WEST Dex on the same terms and conditions as it makes them available to other publishers. See Aff., ¶ 7. In fact, under the Supreme Court's decision in Feist Publications, Inc. v. Rural Tel. Serv. Co., 499 U.S. 340 (1991),

the compilation of telephone number listings in a White Pages directory is not entitled to copyright protection. Such listings can thus freely be copied by competing publishers.<sup>11</sup>

Accordingly, "[t]he majority of courts . . . have held . . . that the yellow pages portion of a telephone directory primarily is a matter of private business. These courts have found generally that the yellow pages portion of a telephone directory is simply one source of advertising and does not constitute a monopoly service such as the furnishing of telephone service proper." Mountain States Tel. & Tel. Co. v. Public Serv. Comm'n, 745 P.2d 563, 570 (Wyo. 1987). In the Mountain States case, the Wyoming Supreme Court held unlawful the public service commission's attempt to require Mountain Bell (now USWC) to rescind the transfer of its publishing assets to Landmark Publishing Company (now U S WEST Dex).<sup>12</sup>

Other courts have enforced limitation of liability clauses in advertising contracts because those clauses relate to the telephone company's additional service of providing advertising in the Yellow Pages, rather than to the company's public service function as a communications common carrier. In fact, "the overwhelming majority of cases have upheld"

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<sup>11</sup> Even prior to Feist, courts held that telephone listings are not "essential facilities," even for white pages, because competitors can replicate listings through independent surveys cross-checked against the published directory. See Directory Sales Management Corp. v. Ohio Bell Tel. Co., 833 F.2d 606, 612-13 (6th Cir. 1987); White Directory of Rochester, Inc. v. Rochester Tel. Corp., 714 F. Supp. 65, 70 (W.D.N.Y. 1989).

<sup>12</sup> See also Classified Directory Subscribers Ass'n v. Public Serv. Comm'n, 383 F.2d 510, 512 (D.C. Cir. 1967) (public service commission disclaimed jurisdiction over "advertising published in the Classified Directory because such advertising was not essential to telephone service and did not, in itself, constitute a public utility service or facility"); In re Northwestern Bell Tel. Co., 367 N.W.2d 655, 660 (Ct. App. Minn. 1985) (commission lacks jurisdiction over Yellow Pages publishing agreement because the predecessor of U S WEST DEX "is only in the business of publishing directories. . . . [It] is not a telephone company."); Wyo. Stat. § 37-15-104(a)(iv) (clarifying that public service commission jurisdiction does not extend to directory publishing).

such contract provisions. Electronic Security Systems Corp. v. Southern Bell Tel. and Tel. Co., 482 So.2d 518, 519 (Fla. App. 1986); see, e.g., McTighe v. New England Tel. & Tel. Co., 216 F.2d 26, 27 (2d Cir. 1954) ("The publication of the classified directory [Yellow Pages] . . . is wholly a matter of private contract and contracts relating thereto are not required to be filed with the Public Service Commission [of Vermont] which has no jurisdiction except over matters relating to the public utility services rendered by the company and the rates relative thereto."); Pinnacle Computer Servs., Inc. v. Ameritech Pub., Inc., 642 N.E.2d 1011, 1014, 1017 (Ind. 1994) (Yellow Pages publishing unit is "a separate legal entity and not a public utility. The publication of the Yellow Pages in a telephone directory is wholly a matter of private concern" and "'not part of a telephone company's public utility business'" (citation omitted); McClure Engineering Assocs., Inc. v. Reuben H. Donnelly Corp., 447 N.E.2d 400, 403 (Ill. 1983) (finding "persuasive the many decisions in other jurisdictions which recognize that yellow pages advertising is a nonregulated activity"); Richard A. Berjian, D.O., Inc. v. Ohio Bell Tel. Co., 375 N.E.2d 410, 415 (Ohio 1978) ("In the overwhelming majority of jurisdictions confronting the issue of whether the classified advertising service is a service within the scope of the duties owned by the telephone company to the public, courts have found such service to be a matter of private concern only . . . . Thus, with respect to the classified directory service, this court finds that the telephone company is not in a position comparable to that of a public utility required to provide a specific and necessary service to the public."); Affiliated Professional Servs. v. South Central Bell Tel. Co., 606 S.W.2d 671, 672 (Tenn. 1980) ("almost every appellate court which has considered the frequently litigated question presented in the present

case has sustained the provisions of the contract limiting liability of the telephone company and its soliciting agent").<sup>13</sup>

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<sup>13</sup> See also Bernstein v. G.T.E. Directories Corp., 631 F. Supp. 1551, 1552-53 (D. Nev. 1986); Vails v. Southwestern Bell Tel. Co., 504 F. Supp. 740, 742 (W.D. Okla. 1980); Pilot Industries v. Southern Bell Tel. and Tel. Co., 495 F. Supp. 356, 360-61 (D.S.C. 1979); Modern Equip. Corp. v. Puerto Rico Tel. Co., 440 F. Supp. 1242, 1243 (D.P.R. 1977); Robinson Insurance & Real Estate, Inc. v. Southwestern Bell Tel. Co., 366 F. Supp. 307, 310-11 (W.D. Ark. 1967); Holman v. Southwestern Bell Tel. Co., 358 F. Supp. 727, 728 (D. Kan. 1973); Wheeler Stuckey, Inc. v. Southwestern Bell Tel. Co., 279 F. Supp. 712, 715 (W.D. Okl. 1967); Georges v. Pacific Tel. & Tel. Co., 184 F. Supp. 571, 576 (D. Or. 1960); Neering v. Southern Bell Tel. Co., 169 F. Supp. 133, 134 (S.D. Fla. 1958); Mendel v. Mountain States Tel. & Tel. Co., 573 P.2d 891, 892 (Ct. App. Ariz. 1977); Davidian v. Pacific Tel. and Tel. Co., 16 Cal. App.3d 750, 754, 94 Cal. Rptr. 337, 339 (1971); University Hills Beauty Academy, Inc. v. Mountain States Tel. and Tel. Co., 554 P.2d 723, 724-25 (Colo. App. 1976); Ed Fine Oldsmobile, Inc. v. Diamond State Tel. Co., 494 A.2d 636, 637-38 (Del. 1985); Southern Bell Tel. and Tel. Co. v. C & S Realty Co., 233 S.E.2d 9, 11-12 (Ga. App. 1977), overruled in part on other grounds, Georgia-Carolina Brick and Tile Co. v. Brown, 266 S.E.2d 531 (Ga. App. 1980); McClure Eng'g Assocs. v. Reuben H. Donnelley Corp., 428 N.E.2d 1151, 1154 (Ill. App. 1981) aff'd, 447 N.E.2d 400 (Ill. 1983); Woodburn v. Northwestern Bell Tel. Co., 275 N.W.2d 403, 405 (Iowa 1979); Wille v. Southwestern Bell Tel. Co., 549 P.2d 903, 910 (Kan. 1976); Louisville Bear Safety Serv., Inc. v. South Central Bell Tel. Co., 571 S.W.2d 438, 440 (Ky. 1978); Roll-up Shutters, Inc. v. South Central Bell Tel. Co., 394 So.2d 796, 798 (La. Ct. App.), cert. denied, 399 So.2d 599 (La. 1981); Wilson v. Southern Bell Tel. and Tel. Co., 194 So.2d 739, 742 (La. Ct. App. 1967); Baird v. Chesapeake & Potomac Tel. Co., 117 A.2d 873, 878 (Md. Ct. App. 1955); Warner v. Southwestern Bell Tel. Co., 428 S.W.2d 596, 602-03 (Mo. 1968); Montana ex rel. Mountain States Tel. and Tel. Co. v. District Court, 503 P.2d 526, 529 (Mont. 1972); RK's Landscaping v. New England Tel. & Tel. Co., 519 A.2d 285, 286 (N.H. 1986); Gas House v. Southern Bell Tel. and Tel. Co., 221 S.E.2d 499, 505 (N.C. 1976), overruled in part on other grounds, North Carolina ex rel. Utilities Comm'n v. Southern Bell Tel. and Tel. Co., 299 S.E.2d 763 (N.C. 1983); Federal Bldg. Serv. v. Mountain States Tel. & Tel. Co., 417 P.2d 24, 24-25 (N.M. 1966); Hamilton Employment Serv. v. New York Tel. Co., 253 N.Y. 468, 471, 171 N.E. 710, 711 (1930); Cunha v. Ohio Bell Tel. Co., 271 N.E.2d 321, 323-24 (Ct. C.P., Cuyahoga Co. 1970); Behrend v. Bell Tel. Co. of Pa., 390 A.2d 233, 235 (Pa. 1978); Smith v. Southern Bell Tel. & Tel. Co., 364 S.W.2d 952, 955 (Tenn. App. 1962); Wade v. Southwestern Bell Tel. Co., 352 S.W.2d 460, 463 (Tex. Civ. App. 1961); Atkin Wright & Miles v. Mountain States Tel. and Tel. Co., 709 P.2d 330, 335 (Utah 1985); Morris v. Mountain States Tel. and Tel. Co., 658 P.2d 1199, 1201 (Utah 1983); Allen v. General Tel. Co., 578 P.2d 1333, 1335-36 (Wash. App. 1978); Annot., 92 A.L.R. 2d 917, 935; see also A-ABC Appliance of Texas, Inc. v. Southwestern Bell Tel. Co., 670 S.W.2d 733, 734-36 (Tex. App. 1984) (directory publisher was free to contract privately and refuse advertisement that violated its standards).

All of these authorities recognize that there is a distinction between Yellow Pages publishing and telephone service. Yellow Pages revenue imputation cannot be justified as an "accounting adjustment."

## **II. IMPUTING YELLOW PAGES REVENUE TO LOCAL TELEPHONE SERVICE VIOLATES THE FIFTH AND FOURTEENTH AMENDMENTS**

Imputing Yellow Pages revenue to local telephone service violate USWC's rights under the Fifth and Fourteenth Amendments, without regard to whether it results in a confiscatory rate of return. The resources used in Yellow Pages publishing belong to U S WEST Dex, not to USWC. No telephone customer funds the publication of Yellow Pages. If U S WEST Dex sustained a loss from Yellow Pages publishing, local telephone customers would not pay for it. Further, Yellow Pages publishing is not an activity associated with the furnishing of telephone service by USWC but rather an asset belonging to U S WEST Dex and its shareholders.

Imputation thus ignores the constitutional principle that the property of a public utility belongs to the company and its stockholders, not to ratepayers or the government. "The relation between the company and its customers is not that of partners, agent and principal, or trustee and beneficiary." Board of Pub. Util. Comm'rs v. New York Tel. Co., 271 U.S. 23, 31 (1926). "Customers pay for service, not for the property used to render it. . . . By paying bills for service, they do not acquire any interest, legal or equitable, in the property used for the convenience or in the funds of the company." Id.; see also Pacific Gas & Elec. Co. v. Public Utilities Comm'n, 475 U.S. 1, 22 n.1 (1986) (Marshall, J., concurring in the judgment); Simpson v. Shepard, 239 U.S. 352, 454 (1913) (a utility's "property is held in private ownership").

This constitutional rule is especially salient here, because no ratepayer funds are involved — or are put at risk — in the publication of Yellow Pages. In setting rates, the “guiding principle” is that “the gain belong[s] to those — investors or consumers — who previously bore the risk of loss from possible decline in market value.” Democratic Central Comm. v. Washington Metro. Area Transit Comm’n, 485 F.2d 786, 796 (D.C. Cir. 1973). “[T]he right to capital gains on utility assets is tied to the risk of capital losses,” and “he who bears the financial burden of particular utility activity should also reap the benefit of resulting therefrom.” Id. at 806; see also City of Lexington v. Lexington Water Co., 458 S.W.2d 778, 780 (Ky. 1970) (“Profit made from the sale of non-depreciable land no longer used in serving customers is not an ingredient to be considered in fixing rates. The customers had no interest in the profit realized on the sale — it belonged to the stockholder”).

Hence, imputing Yellow Pages revenue to USWC means that rates for its regulated telephone service are set in part by reference to a non-public-utility activity involving property in which telephone ratepayers have no interest. The regulators are imputing revenues derived not from any transaction involving USWC or telephone service, but from transactions between U S WEST Dex and private advertisers. Such an imputation violates the Takings and Due Process Clauses, whose prohibition on confiscatory rates necessarily includes a limitation on a state regulator’s ability to set a utility’s rates by reference to non-public-utility businesses involving property in which ratepayers have no interest, as well as other activities outside the regulator’s jurisdiction. Otherwise, imputation would have no limit. If U S WEST used its own property to set up a steel mill, for example, under the